Monthly Letter on Economic Conditions Government Finance

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General Business Conditions

THE new year has begun auspiciously, not only because production and trade are high and order books well-filled, but also because understanding of present dangers in the economic situation seems to be spreading and precautions against them are being taken to a gratifying extent. Merchants are reducing commitments and moving to get inventories in shape, and the caution extends to industrial buying also. Meanwhile the likelihood of major strikes in the months just ahead is diminishing.

Some business men in public statements have taken the view that warnings of possible recession are "defeatist" and do harm because the country will be "talked into depression." Evidently they think that what happens in business is mostly a matter of how people feel about the future, and that if people will continuously reassure each other they will keep on spending, borrowing and making commitments and all will be well.

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Everyone knows, however, that inflationary booms eventually come to an end. Usually it is an excess of optimism and disregard of warnings which carries them to extremes. Warnings were offered in 1919, again in 1928 and 1929, and again in 1937 – warnings not only in estimates of the situation by experienced business leaders, economists, and government agencies, but in the action of various markets, including the money markets. The same objection that the country was being talked into depression was heard, and in 1920 and 1929 the monetary authorities particularly were accused of trying to stifle business. Everyone knows now that the warnings should have been heeded more widely, and possibly the individuals who decried them were the ones who experienced the worst losses.

Benefits of Restraint

The present boom could be carried still further by a concerted closing of eyes to its dangers. But by the same token speculative buying ultimately would be overdone, inventories – including those of consumers – overexpanded, debt overextended, and costs and prices forced still higher. When the turn finally came people would have too many goods and too many commitments at unsupportable prices, losses would be heavy and the resulting correction in production, employment and trade would be severe.

Conversely, if restraint and caution are exercised before things get too far out of hand the reaction will be less damaging. The Council of Economic Advisors in its first report published in December said that "in spite of certain conditions that might make a dip in 1947, we believe that courageous and sensible action . . . can at least hold such a recession to moderate proportions if not avert it." The foundation for "courageous and sensible action" is analysis of the dangers and weaknesses, and understanding of the nature of the corrections needed.

In fact, if all written or spoken forecasts were suppressed business would still have warnings before it. They have been uttered by various markets, including the stock market last Summer and luxury goods and services and a good many foods and farm products more recently. These market warnings point to the danger of excessive commitments at inflated prices, and to the instability of demand when it is swollen by excessive speculation or inventory accumulation. Above all they indicate that another upward turn of the cost-price spiral should be avoided. They make it clear that there is such a thing as pricing goods out of the market, which is another way of saying that some prices and some costs are too high, in relation to other prices and to the purchasing power of people who want to buy the product.

The economic situation is strong in many respects. It is strong financially, it is strong in the conjunction of urgent needs at home and abroad with an unprecedented volume of money and liquid assets, and it is strong in that enterprise is vigorous and investment expanding. Existence of these and other supporting factors affords time to get inventories and commitments in order, realign prices, increase the efficiency of production and reduce costs. If this time is used to advantage the predicted recession, as the Council of Economic Advisors states, can be moderated and perhaps averted. If warnings of danger have this effect they should be welcomed.

The Ford Price Cut

From that viewpoint the action of the Ford Motor Co. announced January 15, reducing prices of its automobiles, is in every respect an act of foresight and economic statesmanship. Everyone knows that a sellers' market exists in automobiles, with new cars offered for resale still commanding a premium over manufacturers' prices, and Mr. Henry Ford, 2nd, in announcing the cut said that more than one million customers were waiting for delivery at present prices. Moreover, the company in 1946 had made a profit only during the fourth quarter.

However, Mr. Ford saw economic stability threatened and felt that leadership was called for. His public statement said:

> This is our "down payment" toward a continued high level of production and employment in the months ahead. We believe that the "shock treatment" of prompt action is needed to halt the insane spiral of mounting costs and rising prices and to restore a sound base for the hopeful period of postwar production we are now entering . . .
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> The un-American spiral of mounting costs and rising prices has hurt everybody—some groups more than others. Many have not benefited from postwar wage increases, but they have had to share the burden of resulting higher prices. Already millions of American families are unable to buy the things which, in normal times, make up their standard of living.
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> In the short view, we can see inflation. In the long view, there is danger of depression . . .
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> We have decided that now is the time for us to make an investment in the future . . . We hope that our suppliers, our employes and our other economic partners will back, each to his own ability, our attempt to return to the economic pattern which has helped to make America great—the principle that higher wages and a higher standard of living for all depend upon lower costs and lower prices through increasingly efficient large-scale production.

Mr. Ford did not refer directly to the new wage demands, including that of the United Automobile Workers' union for a 23½c increase, which are based on the argument that the real purchasing power of consumers has been diminished by price rises. But he made in the only way open to him a contribution toward increasing consumers' real purchasing power. Thereby he would help diminish pressure for wage increases, which would start another revolution of the inflation spiral. Through the price cut a million purchasers of cars will benefit, a number many times greater than that of the U.A.W. employes in the Ford plants. This is a concrete illustration of the greater dissemination and more widespread benefits of price reductions for the many, as contrasted with wage increases for the few.

Many of the Ford Company's suppliers have joined Mr. Ford's effort by reducing prices of the things they sell to him. In the consumers' goods industries there are a good many cases, less conspicuous than the Ford move but substantial in the aggregate, where prices have been held unchanged against increased costs, or reduced where costs permitted. Markdown sales at retail are fairly common, and retailers are telling manufacturers that they must get prices down or quality up, or both. Manufacturers have to contend with high and inflexible wage costs, and adjustment to competitive prices may not be painless, but in the long run competition must govern.

Mr. Ford says that he intends to operate in the black, and that "we hope we will not be forced to raise prices again to compensate for cost increases." He is not proposing, therefore, that business give up profits or forego replenishment of depleted reserves. Rather he asks for cooperative effort by everyone to get prices down, each to the extent of his ability. In view of the prestige and leadership of the Ford Company it is safe to say that, through force of this example, industrial price reductions will be earlier and broader than otherwise would occur.

Labor is also gaining purchasing power through declines in the food component of the cost of living. Food prices in general have moved downward during January for the second consecutive month. The price of butter again made the headlines, another sharp drop bringing it down close to the old OPA ceiling price plus the subsidy. Other reductions occurred in livestock, meat, and poultry. Grain prices stiffened on an announcement that the export goals for the last half of the season had been stepped up, but distant deliveries in the future markets, still under the influence of the favorable wheat crop outlook, are at substantial discounts under the spot markets. Without exception, the futures markets point to lower food prices after the next harvest.

With food prices taking this course, and the Ford and other examples in the industries, the argument that labor should make its next gains in living standards by waiting for prices to come down and taxes to be reduced, rather than forcing wage increases which would hold prices up or cause further rises, has been strengthened immensely. The one thing that will prevent prices from coming down is an increase in wage costs.

Other Constructive Developments

Another constructive development of January is the evidence that the labor unions are not presenting this year's wage demands in the same truculent take-it-or-leave-it attitude that they adopted a year ago. In a number of cases, including the U. S. Steel Corporation and the Chrysler Corporation, the unions have extended present contracts in order to leave ample time for negotiations. What the situation may be when the extension runs out is of course uncertain, but the gain in time and the evidence of a give-and-take attitude are both helpful.

Additional time may bring persuasive indications that the cost of living is passing over its peak and that labor can put trust in the prospect for reductions. It may also persuade union leaders that the ability of employers to pass on increased costs in sellers' markets cannot be counted on indefinitely, and that by pushing exorbitant demands they would risk unemployment. This also would affect bargaining attitudes. The union leaders know that major strikes this year would alienate public opinion and make more likely passage of legislation drastically curtailing their powers. This is in marked contrast to last year, when labor's most extreme wage demands were actively supported by the Government.

In the business news the tendency of buyers to shorten commitments is conspicuous. The National Association of Purchasing Agents reports that whereas in December most buyers were committing themselves three to six months ahead, in January 72 per cent of those reporting were buying only for three months or less. This reflects determination to get inventories and commitments in order. Retail commitments have been cut substantially. Progress in reducing inventories has been slower because receipts of goods have been heavy, and the drop in department store stocks during December in percentage was not as great as in previous years. Shortening of commitments, however, is the prelude to getting inventories in order.

Adjustments of this kind will tend to sustain and prolong the period of high production and employment. The need is to have the situation in order against the time when deferred demands are more nearly satisfied, and when inflationary influences lose their momentum. The governing factor in business then will be the extent to which the change has been prepared for, and the extent to which prices have been brought into line with each other and with capacity to pay.

The $37.5 Billion Budget

The revelation in the President's budget message transmitted to Congress last month of a federal budget precariously balanced at the enormous total of $37.5 billion for the fiscal year 1948, beginning next July, has come as a shock and heavy disappointment. Whereas the country had counted on sharp curtailment in government spending to give leeway both for a start on debt retirement out of surplus revenues and for some relief from the crushing weight of taxes, it now sees these hopes going out the window unless Congress takes a hand with drastic and determined action to pare down the still immensely swollen government costs.

With revenues estimated at $37.7 billion, there is a bare $200 million of surplus indicated in the President's figures. This is hardly any surplus at all, considering the hazards of budget making and the huge totals of both income and outgo.

In order to bolster this minute margin "in the black," the President asks Congress to continue through fiscal 1948 the wartime excise tax rates which under present law would expire July 1, 1947, and to raise postal rates sufficiently to wipe out the postal deficit. Such action, he calculates, would raise the budget surplus to $1.8 billion. "There is," he declares, "no justification now for tax reduction."

This is indeed a depressing picture. Although the war will have been over nearly two years by July 1 next, the $37.5 billion budget means,

as shown by the accompanying long-term table, that the Government is planning to spend in that year alone more than was spent over the whole period of World War I. It means spending more than four times as much as in the biggest spending years of the '30s when relief and pump-priming outlays and the general philosophy of pouring out government money had already lifted the budget beyond anything previously dreamed of for a peacetime year.

United States Government Budget Receipts and Expenditures 1914-1948
(In Millions of Dollars)

Year Ended June 30	Total Net Receipts	Expenditures: National Defense	Expenditures: All Other	Expenditures: Net Total	Net Surplus or Deficit
1914	$ 735	$ 263	$ 472	$ 735	$ 0
1915	698	268	493	761	− 63
1916	783	286	448	734	+ 48
1917	1,124	1,452	526	1,978	− 853
1918	3,665	10,838	1,859	12,697	− 9,033
1919	5,152	14,444	4,071	18,515	−13,363
1920	6,995	2,718	3,685	6,403	+ 292
1921	5,625	1,767	3,349	5,116	+ 509
1922	4,109	888	2,485	3,373	+ 736
1923	4,007	675	2,620	3,295	+ 712
1924	4,012	603	2,446	3,049	+ 963
1925	3,780	626	2,437	3,063	+ 717
1926	3,963	599	2,499	3,098	+ 865
1927	4,129	614	2,360	2,974	+ 1,155
1928	4,042	643	2,460	3,103	+ 939
1929	4,033	698	2,601	3,299	+ 734
1930	4,178	721	2,719	3,440	+ 738
1931	3,190	667	3,004	3,652	− 462
1932	2,006	664	3,871	4,535	− 2,529
1933	2,080	651	3,213	3,864	− 1,784
1934	3,116	578	5,433	6,011	− 2,895
1935	3,800	726	6,284	7,010	− 3,210
1936	4,116	940	7,726	8,666	− 4,550
1937	5,029	967	7,210	8,177	− 3,148
1938	5,855	1,066	6,173	7,239	− 1,384
1939	5,165	1,074	7,953	9,027	− 3,862
1940	5,387	1,497	7,800	9,297	− 3,910
1941	7,607	6,370	7,395	13,765	− 6,158
1942	12,799	26,843	7,447	34,290	−21,491
1943	22,282	70,031	9,671	79,702	−57,420
1944	44,149	83,724	11,849	95,573	−51,424
1945	46,457	84,526	15,872	100,398	−53,941
1946	43,038	45,012	18,702	63,714	−20,676
1947‡	40,230	14,726	27,797	42,523	− 2,293
1948†	37,730	11,256	26,272	37,528	+ 202

United States Government Public Debt. 1914-1948
(In Millions of Dollars)

June 30	Total	June 30	Total	June 30	Total
1914	$ 1,188	1926	$19,643	1938	$37,165
1915	1,191	1927	18,510	1939	40,440
1916	1,225	1928	17,604	1940	42,968
1917	2,976	1929	16,931	1941	48,961
1918	12,244	1930	16,185	1942	72,422
1919	25,482	1931	16,801	1943	136,696
1920	24,298	1932	19,487	1944	201,003
1921	23,976	1933	22,539	1945	258,682
1922	22,964	1934	27,053	1946	269,422
1923	22,350	1935	28,701	1947‡	260,400
1924	21,251	1936	33,778	1948†	260,200
1925	20,516	1937	36,425		

Source: Compiled from President's Budget Messages and Annual Reports of the Secretary of the Treasury. Expenditures exclude net appropriations to old-age insurance trust funds, while corresponding social security taxes are excluded from net receipts. Expenditures exclude sinking fund for debt retirement, but include government corporation net expenditures beginning with 1939. National defense total excludes expenditures charged to War Department for rivers and harbors, and flood control; also for Panama Canal; but includes loans to foreign governments in 1917-21 and lease-lend in 1941-48. †Budget estimate. ‡Revised budget estimate.

The following table gives original and revised budget estimates for this fiscal year, together with the estimates for fiscal '48 both before and after allowance for the President's recommended retention of wartime excise taxes and increase in postal rates.

Comparison of U. S. Government Budget Totals for Fiscal Years 1947 and 1948
(In Millions of Dollars)

	1947 Budget: Jan. '46 Est.	1947 Budget: Jan. '47 Est.	1948 Budget: Jan. '47 Est.	1948 Budget: Recommended*
Total expenditures	$35,860	$42,523	$37,528	$37,100
Net receipts	31,513	40,230	37,730	38,900
Surplus or deficit	—4,347	—2,293	+202	+1,800

*Allowing for maintenance of wartime excise rates and elimination of postal deficiency by higher rates.

As this table shows, the $37.5 billion of expenditures budgeted for fiscal '48 is $5 billion less than is now figured for fiscal '47. But the new estimate for this year represents a stepping up of $6.7 billion over the original estimate made in January a year ago.

But for the fortunate fact that indicated revenues were boosted an unexpected $8.7 billion by the high level of business and expansion of national income, we would be facing a Treasury deficit this year of anywhere up to $11 billion, instead of the $2.3 billion deficit now regarded as probable.

A Budget Out of Control?

Because of this continued high rate of spending, the Government finds itself in the unhappy position of scarcely being able to balance the budget, despite a tax structure practically at the wartime high (except for elimination of the corporate excess profits tax) and boom conditions in industry, trade, and employment. If we cannot, under these favorable conditions, generate enough of a Treasury surplus to pay off debt and reduce taxes, when can we hope to do so?

There are certain substantial expenditures, theoretically terminable after a transition period, still included in the budget, notably in connection with foreign relief and reconstruction, occupation costs, and veterans' demobilization. But to count upon much net saving in overall costs from such sources would be leaning on a slender reed. It had been generally supposed that non-recurring items in the budget this year would permit more important reductions in the 1948 budget, but part of these expected savings is offset by increases for existing programs and outlays for new projects.

What all this adds up to is that we have a budget that is out of hand. Unless Congress, with the backing of the public, can reestablish

control over expenditures and get us on the sound road of paying off debt and lightening the tax load now bearing down upon the incentive for work and production, we are heading for serious trouble. It is gravely doubted that the country can resume the dynamic growth and prosperity of the past under the weight of taxes required by $37 billion of government spending annually. There is no surer way to kill enterprise than by taking the heart out of people with taxes. The problem is to arouse the people to the danger, that they may demand and support action by Congress in doing something about it.

Where the Money Goes

In the following table we give the breakdown of the proposed $37.5 billion of expenditures for fiscal '48, according to the new functional classification used in the budget, together with comparative figures for 1939. Figures include net expenditures of wholly-owned government corporations.

Budget Expenditures by Major Programs
(In Millions of Dollars)

	1939	1948
National defense	$1,074	$11,256
Veterans' services and benefits	559	7,343
Interest on the public debt	941	5,000
International affairs and finance	19	3,510
Refunds of tax receipts	68	2,065
Social welfare, health and security	3,996	1,654
Transportation and communication	512	1,530
General government	556	1,492
Agriculture and agricultural resources	1,198	1,381
Natural resources	214	1,101
Housing and community facilities	154†	539
Finance, commerce and industry	52	426
Labor	11	118
Education and general research	44	88
Reserve for contingencies	....	25
Adjustment to daily statement basis	63†	....
Total expenditures	$9,027	$37,528

†Excess of credits, deduct.

It will be seen that five items alone – national defense, veterans' services and benefits, interest on the public debt, international affairs and finance, and tax refunds – come to $29.2 billion, or almost four-fifths of the total budget.

In these items we see the major reflection of the cost of the war and its aftermath of debt, greatly expanded military establishment, veterans' demobilization costs, benefits, and pensions, and cost of our participation in foreign relief and reconstruction. That expenditures under these classifications should show a large increase over prewar is unavoidable; but whether all of these huge disbursements are necessary and warranted is a matter that calls for careful investigation.

Interest on the national debt and statutory tax refunds are contractual obligations that must, of course, be met. All other groups of expenditures listed in the table are, however, in a different category so far as possibilities of change are concerned. To approve these expenditures in principle is not to imply unquestioning acceptance of everything proposed under these headings. In the search for savings, the only way is to reexamine the whole mass of these appropriations and commitments without excluding any. If we start out by excluding national defense, veterans, international obligations, and others we shall get nowhere.

Costs of National Defense

The $11.2 billion for national defense is the largest item and certain to come under close scrutiny by Congress. This provides for an averare military strength of 1,641,000 men and officers, including an Army of 1,070,000 and Navy and Marine Corps averaging 571,000.

Of the total expenditures by the War and Navy Departments, $5.2 billion, or 45 per cent, is for pay, subsistence, travel, welfare, training, clothing, and medical expenditures. This leaves $6.0 billion for all other purposes, including procurement, research and development, construction, operation and maintenance, and citizen reserve activities. The budget does not include estimates for the universal training program which is now under consideration.

Just how much scope remains for savings in this vast and complicated area of the budget is a question for thorough examination. Certainly it cannot be said too emphatically that there ought to be no "economy" that imperils the national security or hampers the efficient carrying out by the armed forces of the jobs they have to do. As the President said, we have large responsibilities arising out of the war, and the cost of military occupation in Europe and the Far East comes high. Slow progress in making the peace treaties has retarded the decline in these costs. A clearing of the international political skies would open the way to substantial cuts in occupation costs; until then we cannot afford to take chances by premature weakening of our forces abroad.

But, allowing for all this, there is still a question as to whether all avenues of savings have been fully explored. The President calls attention to his recommendation for a single department of national defense as an "important step in the search for economy and efficiency in organization and administration of the armed services." The recently announced agreement by the Army and Navy on a "unification" plan carries this program a step further, but economies, if any, are a long, rather than a short, range hope.

More immediately, the task is to make sure that these departments are being administered with maximum efficiency, with every effort to avoid waste of manpower and materials. It is startling, for example, to find that as late as November the War and Navy Departments were still employing more than a million civilians. The task of shrinking down a big organization is always difficult, and bureaucratic inertia is as likely to be present in these branches of the Government as in any other. An impression prevails among many business men having contacts with Army and Navy purchasing divisions that some orders are being placed beyond actual needs and for munitions likely to be obsolete before they are completed.

A basic question in connection with these huge expenditures is the extent to which the services are adjusting their programs to the lessons of modern warfare and the progress of scientific discovery. On this point it is significant that the Army and Navy budget for fiscal '48 contains projected expenditures of $530 million for "research and development", in addition to $443 million for the atomic energy program carried under "Natural Resources." The combined total – $973 million – highlights the problem of discrimination to avoid pouring out money on methods and mechanisms which scientific developments and changed methods of warfare have rendered obsolete.

Even in the matter of research, experience has shown that it cannot be purchased by the yard or pound. Research calls for the highest competence, and skilled manpower is the limiting factor. Expenditures beyond this point are wasteful.

Veterans' Benefits

The second largest item in the $37.5 billion budget is the $7.3 billion to be spent for veterans' pensions and benefits. Most of the benefits will be provided under the Servicemen's Readjustment Act (so-called GI bill of rights), covering education and training benefits, unemployment and self-employment allowances, and loan guarantees. What this means in terms of dollars and cents for fiscal '48 is indicated by the following table.

Veterans' Services and Benefits
(In Millions of Dollars)

	Estimated Fiscal '48
Readjustment benefits	$3,462
Pensions	2,492
Insurance	73
Hospitals, other services and administrative costs:	
Construction	424
Current expenses	892
Total	$7,343

The budget reports "the most extensive hospital and domiciliary construction program in the history of this nation," the total facilities now authorized and recommended aggregating $1 billion, less than half, however, to be completed by the end of the coming fiscal year.

In explaining these heavy expenditures, the budget gives figures that ought to be more widely circulated and understood on the cost of various programs. Thus, in fiscal '48 possibly 2.1 million veterans are expected to participate in education and training benefits under the G. I. bill alone at a cost to the Treasury of over $2.3 billion. At the present time, the number of trainees receiving on-the-job training benefits has risen to over 600,000. Amendments liberalizing the loan guarantee program have brought a sharp increase in the number of loans guaranteed and in the average size of the guarantee. During fiscal '47 new guarantees (chiefly for home purchases) are expected to be made for 750,000 veterans, and in fiscal '48 for possibly 1 million veterans.

Particularly noteworthy are the continuing heavy expenditures for veterans' unemployment compensation at a time of high level business activity and widespread labor shortages. Thus, in the current fiscal year almost 1.1 million veterans, on the average, are drawing unemployment allowances and more than 200,000 are receiving self-employment allowances at a time when, as the budget message points out, total unemployment in the United States is less than 2.5 million. The President states that a tightened administration and a more positive job placement program have contributed to a reduction in the numbers on the allowance rolls, but he still anticipates for fiscal '48 that some 900,000 veterans on the average will be on the rolls at a cost of nearly $1 billion.

Pensions and compensation to disabled veterans and dependents will run to $2.5 billion in 1948. The last session of Congress increased pension rates, and the number on the pension rolls is estimated to rise for many years.

In all these veterans' benefits, the problem is to see that the deserving veteran gets the help he needs and that the benefits do not serve as an inducement to unwise financial commitments on the part of the veteran or as an invitation to idleness or other abuse. As the President says in his budget message –

> Since the main purpose of our veterans' program is to re-establish former servicemen in civilian life, we must carefully avoid types of assistance which would encourage, or unnecessarily prolong, dependence upon government subsidy. Any other policy would not only put an

intolerable burden upon the taxpayer, but would be a great disservice to veterans themselves.

Unfortunately, too many veterans are taking advantage of the Government's generosity. This is evident both in the way the unemployment program has been working and in reports of fraud in the training program. Padding of pension rolls is an old racket which grows more flourishing as the number of potential claimants increases. In all communities instances of abuse of veterans' privileges are matters of common knowledge, and General Bradley, Administrator of Veterans Affairs, has referred publicly to the minority of veterans who have been content to sit back and let the Government look after them.

A question Congress might find worth looking into is to what extent veterans' non-service disabilities are contributing to the over-crowding of veterans' hospitals, with consequent disadvantage to service-connected disability cases, increased maintenance expense, and need for new and costly construction. Out of 109,000 cases in veterans' hospitals and homes on Oct. 31, 1946, more than two-thirds were non-service connected. While veterans who can pay for medical attention on non-service connected cases are not supposed to be included, the check-up is said to be lax. These cases will probably mount in number, and operating costs will go up further, as time goes on and as more facilities are made available.

Correction of abuses is partly a matter of administration all down the line, but may be partly a matter of legislation as well. In any event enough has come out to show that corrections are needed, and with the expenditures so huge the time has long passed when anything can be considered sacred merely because it is labelled "veterans." While action may require political courage, measures to eliminate abuses should have the approval of the great majority of veterans. With their number approaching 20 million, they will before long constitute a large segment of the taxpaying public and already they have a big stake as taxpayers in seeing that funds for the benefit of former servicemen and servicewomen are not used improvidently.

International Finance

International affairs and finance, at $3.5 billion, looms as the fourth largest expenditure grouping in the '48 budget, representing a still heavy, though diminishing, contribution to foreign relief and reconstruction.

Further drafts of $1.2 billion under the British credit, $730 million of already authorized funds for the Export-Import Bank, and $645 million for relief in foreign areas occupied by U. S. troops represent the principal items. There is $305 million for wind-up of UNRRA, and $326 million to cover additional relief in a few countries still in desperate need for which the President expects to ask authority of Congress.

While the United States doubtless will continue to respond to special emergency situations in friendly countries, the period of large relief grants and reconstruction loans out of government funds should, in general, be drawing to a close. With the establishment of the International Bank and the International Monetary Fund, requests for credits not suitable for handling through private channels should be taken care of by these institutions or through the facilities of the Export-Import Bank. This is in accord with the statement of principles laid down last Spring by the National Advisory Council on International Monetary and Financial Problems, established under the Bretton Woods Agreements Act.

We have said before, and we say again, that the whole Bretton Woods mechanism was set up on too extravagant and complicated a basis. The two institutions of the Bank and the Fund should have been combined into a single and simpler organization, with much less money involved both in the original subscription from the Treasury and in overhead.

Other Expenses Mount

Apart from the five major items – defense, veterans, interest, international finance, and tax refunds – the 1948 budget proposes expenditures of $8.3 billion for all other government activities and programs. While this may seem a small figure compared with the $29.2 billion for the five leading classifications, it is on a par with average expenditures *for all purposes* in the six years of liberal spending prior to the war.

Commenting upon the rise in the cost of peacetime services compared with prewar, the President says:

> Prewar figures can no longer be used as a yardstick. Although government wages have not been raised so much as private wages, the cost of supplies has risen in line with the cost of goods in private markets. Further, the population to be served has grown since 1939 by 10 million people, adding proportionately to the demand for many public services. Many normal maintenance items had to be postponed on account of the war, and cannot be further neglected. Normal services which were cut down during the war have to be restored.

While there is, of course, a great deal in what the President says, this can hardly be taken as adequate explanation of the mounting trend of expenditures under almost every heading. A

glance back to the table on "Budget Expenditures by Major Programs" shows increases ranging from 100 to more than 900 per cent in most of the so-called nonwar classifications. Only "social welfare, health and security" and "agriculture and agricultural resources" lag behind.

In the case of the former, the decline of 59 per cent is accounted for wholly by a drop in work relief and direct relief expenditures from over $3 billion in 1939 to practically zero in 1948. But for this decline, brought about by the war-induced boom and practical elimination of unemployment other than that financed by veteran and civilian unemployment compensation, expenditures under this heading would be approximately double those of 1939.

As for "agriculture and agricultural resources", it should be pointed out that the total of $1.4 billion for fiscal '48 includes an estimated expenditure of $330 million for support of agricultural prices under the "parity price" support program to which the Government is committed for at least two years after the official termination of the war. As the President says, larger outlays will be required should the markets weaken seriously; and, in the opinion of many agricultural experts, the prospect of large agricultural yields means that price support operations are likely to cost much more than has been allowed for in the budget.

A Record of Extravagance

In short, what the whole budget situation reveals is the discouraging outcome of fifteen years of spendthrift legislation by Congress, directed and urged on by the Administration. It is a good illustration of what happens when money comes easy, and people go on the Micawber philosophy that it is always possible to put off balancing the budget until tomorrow.

In justice to the President, it should be said that the budget gives many evidences of a sincere effort to keep expenditures down. The pressures from all quarters to spend more money are terrific. Moreover, the President, in seeking to reduce costs, is hampered by all sorts of legislative commitments which limit his discretion. To get expenditures down enough to provide real relief to the taxpayer many of these will have to be repealed, shaved down, or allowed to expire.

The President calls attention to various priority and preference provisions which have slowed up the disposal of surplus government property. He recommends gradual reduction of soil conservation payments to farmers, estimated at $311 million for fiscal '48, pointing out that 60 per cent of such payments go to about one-eighth of the nation's farmers who, he asserts, because of their strong position in American agriculture would undoubtedly continue the best farm management practices anyhow. He suggests examination of the possibilities of making charges to cover the cost of certain government services now rendered free, including a reasonable share of the cost of providing specialized transportation facilities, such as airways. We have already referred to his recommended unification of national defense as a measure for economy and efficiency in the armed services.

In calling for an extension of the Reconstruction Finance Corporation beyond its June 30, 1947 expiration date, the President recommends the repeal of "all powers not required for peacetime activities" and a reduction of $2.5 billion in its unused borrowing authority. But it should be possible to go a good deal farther than this. There is no reason why, with the present ample supply of credit, the RFC should be planning to lend next year hundreds of millions of dollars and to put its guarantees on some thousands of loans besides. To do so on the scale projected in the budget will not only use up the substantial proceeds from the liquidation of wartime activities but involve a further drain on the taxpayers' money.

The momentum of programs which got their legislative start in past years is strikingly revealed by the President when he points out that even though no initial appropriations for any new flood control, navigation and reclamation projects are contemplated, expenditures for these purposes will be on the rise through fiscal 1949. An uptrend in civil public works generally has been set in motion by past legislation, some of it in anticipation of a postwar slump. The total figure (spread over a number of the functional classifications) is $1.7 billion for fiscal 1947 and $2.1 billion for fiscal 1948. This uptrend is something that, in the President's words, "deserves careful consideration by the Congress."

All suggestions looking towards removal of legislative barriers to economy, or proposing new avenues of saving, should have the careful consideration of Congress. To be effective, however, measures for economy must have the support of the voters back home. People must see the futility of railing at the Government for "reckless spending" while at the same time clamoring for funds from the Treasury for pet projects of their own. What happened last Summer when local pressures forced modification of a cutback in the public works program is an example of how *not* to make progress in reducing government expenditures.

A Crucial Decision

Paradoxically, while the President was striving to cut down expenditures, he was talking at the same time of the need for expanding social security and for more federal spending in connection with education, health, housing, safe working conditions, and other measures of social welfare. In this conflict we see manifestations of the Administration's dilemma of wanting to practice economy, yet of not wanting to give up the paternalistic ideas that have been prevalent in Washington as to government's role in looking after the individual.

Admirable as the objectives are in themselves, two questions arise: first, to what extent are these federal rather than state and local responsibilities; and, second, where is the money coming from to pay for them along with national defense, veterans, public debt service and all the other things in the budget, without taxes that discourage the individual effort and creation of wealth – the real source of the welfare and progress of the people?

Here we are, with the budget barely in balance, at the highest level of national income ever reached, and this on the basis of a business boom resulting from huge deferred demand and accumulated savings. It would be foolish to think that we can keep on going at this inflationary level. The two things we must do now are (1) to cut down government spending to a level somewhere near our prospective ability to pay, and (2) to try to reestablish conditions which will encourage and stimulate industry and enterprise which are necessary to sustain production and distribution of goods at high levels.

This last means a system in which people who show energy, ability, and leadership have some prospect of reward for their efforts. The present tax system almost obliterates these rewards. It discourages extra effort and penalizes success all up and down the income scale, but especially in the higher surtax brackets where the Government's "take" runs from 50 per cent to nearly 90 per cent of every extra dollar the individual earns. It is upon these higher incomes, affecting a large proportion of the people responsible for the management and growth of American business, that the chief impact of taxation during the war has been placed.

Cutting expenses is one of the hardest things a Congress ever does; and Congress will act only if it hears from the people. Right now decisions are being worked out in Washington that will go far towards determining the kind of society and economy we are going to live in – whether people will be allowed to spend their own money or whether the Government will spend it for them. During the '30s and the war period, the Government intervened in one area after another in our economic life. This big budget assumes the continuance of this philosophy. With it goes a tax system so onerous that it becomes in effect the instrument of socialization by which wealth is redistributed and those who rise above the crowd are cut back to the level of mediocrity.

With the conclusion of the war, it is time we made an abrupt change in this philosophy. What we do about the present budget is a test of how clearly we see this problem and of America's ability to resist the worldwide forces of government dictation and collectivism.

State Government Finances

The Census Bureau of the Department of Commerce in its report of December 1946 once again emphasizes the unusually prosperous condition of state governments. With few exceptions, cash balances are at record levels. The same two influences which built up balances in the war period carried through 1946, namely (1) the continued high volume of tax collections, reflecting high levels of employment, production, and income and (2) the abnormally low rate of capital expenditure occasioned by the shortages of labor, equipment and materials. Total balances in the general, highway, and postwar reserve funds of 28 states reporting were given as follows:

(In Millions of Dollars)

	1943	1944	1945	1946
Total	$734	$1,155	$1,677	$2,207
General funds	446	749	894	927
Highway funds	225	283	348	446
Postwar-reserve funds	63	123	434	834

In the aggregate of these funds, New York State led at $501 million, with California a close second with $490 million. Illinois and Pennsylvania followed with $188 million and $181 million respectively. Accounting methods differ among states, so these balances, while of interest in their aggregate size, may not be strictly comparable.

The Census Bureau remarks that "to a considerable extent the accumulated balances in these three types of state funds represent the deferral of capital outlays – for equipment and for highway and other construction – costs necessarily postponed but in the long run substantially unavoidable." While this implies that accumulated funds will be drawn upon in the

period immediately ahead, it is obvious that state governments are now reaping the reward of guarding their surpluses so jealously throughout the war period.

It is worthy of note that the above table for 28 reporting states shows an accumulation of $2,207 million, just a shade under the $2,358 million gross indebtedness of all states. State governments now possess such a backlog of cash resources that they are well equipped to cope with the problems that lie immediately ahead.

Inaugural Messages

Of the 48 state legislatures, 44 are scheduled to meet this year. Many have already convened; others will meet later. While it is too early to give a broad cost analysis, the indications as to budget demands and revenue requirements follow a closely similar pattern. Governor Dewey, for example, might have spoken for many states when in his inaugural address of January 8th he said:

> The financial position of the State is the strongest in its history . . . We have greatly reduced our indebtdness . . . and accumulated a large surplus for postwar improvements . . . We must hold our postwar fund readily available for construction and reconstruction purposes . . . We must not be deluded by our financial soundness today into excesses which could destroy our financial structure tomorrow. Our State is confronted with demands for new and increased appropriations . . . for social welfare and health . . . for mental hygiene . . . for veterans' housing . . . for teachers' salaries . . . for state employees . . . for pension benefits . . . for youth control, etc., . . . I will recommend that six different taxes carried as 'emergency' levies . . . be made a permanent part of our tax structure.

The pattern ahead for New York State, as outlined by Governor Dewey in the following quotation, might apply elsewhere, judging from many similar programs.

> At April 1, 1947, our state indebtedness will be reduced to some $360 million. But the state debt will be increased by $272 million for low-rent housing already authorized. If the people . . . approve the soldiers' bonus this fall, debt will increase another $400 million. Our state debt may thus increase to more than $1,000 million. And now we are confronted by insistent demands that the State authorize still another $300 million to $500 million for more permanent housing.

While this rising debt outlook in New York is offset by a "postwar construction" fund expected to exceed $600 million by March 31, 1947, nevertheless here and in all other states there has rarely been a greater challenge for sound judgment and prudent debt planning. The problem of administrative bodies will be to use their borrowing power wisely and not to waste it. Debt programs should relate not to the common yardstick used in the past, but to the fact that with the termination of the costliest war in history we have a burden never before approached in federal fixed debt and interest charges to be borne by each family for generations. New debt programs submitted for popular vote should be presented with emphasis upon the cost of repayment as well as the benefits to be derived.

Soldiers' Bonus Proposals

The November elections resulted in the approval of all state soldiers' bonus programs submitted. Up to that time California, Oregon, New Hampshire and Vermont had taken positive action on veterans' aid, but amounts were either covered by offsetting funds or placed on a self-liquidating basis. On the other hand, Maine voters earlier in 1946 had rejected a $16 million bonus payment by a 2-to-1 vote, and legislatures in Missouri, Louisiana and Indiana sidetracked pending bills. The background six months ago therefore seemed to indicate a hesitancy to favor large outright grants apparently in the belief that the Federal Government with the generous considerations embodied in the G. I. bill of rights had given veterans an abundant program of economic protection and education.

Last November's election completely altered any such surmise, for instead of hesitancy, voters expressed a high degree of willingness to approve state payments. The five proposals submitted were approved with substantial majorities:

California	$100,000,000
Illinois	385,000,000
Michigan	270,000,000
Rhode Island	20,000,000
Texas	25,000,000
	$800,000,000

Convening legislatures are now greatly quickening the tempo, for scarcely a week passes without some new bonus bill being thrown into the hopper. The Daily Bond Buyer in its issue of January 29 gave a tabulation, reproduced on the opposite page, of pending financing, proposed bills and tabled items other than the states mentioned above.

With less than half the states reporting, the total enumerated exceeds gross indebtedness of all states by 55 per cent. The parade has by no means ended, for in other states commissions are being appointed or the governor has committed himself to a bonus payment. These proposals have yet to run the gauntlet of committees, legislative action and public referendum, and may emerge in reduced amounts, but if they are approved the record of World War I, with 22 states

State	Millions of Dollars	Status
Colorado	Indefinite	Bill will be introduced
Connecticut	50	Bill introduced in 1947 legislature
Georgia	50	Bill introduced in 1947 legislature
Indiana	40	1945 legislature sidetracked bill
Iowa	90	Bill introduced in 1947 legislature
Louisiana	80	Killed by House of Representatives, 1946
Maine	16	Defeated 1946 election
Maryland	Indefinite	Commission appointed to consider
Massachusetts	170-180	Authorized in 1945 and 1946
Minnesota	45	For consideration 1947 legislature
Missouri	100	Bill introduced in 1947 legislature
New Jersey	100-200	To be considered in 1947
New York	400	Probably to be on 1947 ballot
Ohio	325-500	Bills introduced in 1947 legislature
Pennsylvania	400*	Proposed by various veterans' groups
South Dakota	20-30	Bill introduced in 1947 legislature
Texas	300-500	Bill introduced in 1947 legislature
Washington	100	Bill introduced in 1947 legislature
Total maximum	2,781	
Add	800	Approved in 1946
Add	67	Approved prior to 1946
Grand Total	3,648	

*Added 1/30/47

borrowing $453 million, pales in comparison with what may lie ahead.

Many states have planned postwar construction programs. Our Monthly Letter of February 1946 mentioned that the plans for 26 states totaled $2,394 million, of which all but $376 million was covered by cash on hand or revenues anticipated by the end of construction. While this was a bright picture, materials and labor were then so acutely short that many pressing programs were tabled or postponed. Now that the situation is improving, it seems obvious that action will be taken, for recent inaugural addresses are uniform in the demand for highway construction, low-cost housing, mental and penal institutions and the like. The use of state borrowing power for bonus payments could conceivably retard necessary capital improvements.

The Federal Government's broad program should be considered in judging the need for state bonus payments. The G. I. bill of rights was formulated without consideration of the amounts that state governments might ultimately pay. Its scope was much broader than the combined assistance of the federal and state governments after World War I. In view of the already liberal federal provisions for grants and aid to veterans, running already to more than $7 billion annually, large state bonus proposals call for serious reflection by voters and taxpayers as to ultimate costs and the new taxes by which they would be financed. The suggestion by Governor Dewey that special taxes be levied to retire bonus bonds has the virtue both of providing a specific program of repayment and making clear to the public the increased burden of overall taxes that would be involved for years to come.

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